Approved January 27, 2012

CITY OF SCOTTSDALE
DESERT DISCOVERY CENTER PHASE III FEASIBILITY COMMITTEE

WEDNESDAY, JANUARY 11, 2012

ARIZONA STATE UNIVERSITY SKYSONG
ROOM 301, INGENUITY
1475 NORTH SCOTTSDALE ROAD
SCOTTSDALE, ARIZONA 85257
MINUTES

MEMBERS PRESENT:	Mike Nolan, Chair Patrick Weeks, Vice Chair Ken Travous
ABSENT:	Nancy Dallett Melinda Gulick
STAFF:	Kroy Ekblaw Randy Grant Bill Peifer Joe Padilla Bob Tunis
GUESTS:	John Sather Dan Gruber Bob Brais (telephonic)

Call to Order/Roll Call

Chair Nolan called the meeting of the Desert Discovery Center Phase III Feasibility Committee to order at 8:05 a.m. A formal roll call confirmed a quorum of members present as stated above.

Mr. Ekblaw reported that Lusia Galav has moved on to a new position. In her absence, Randy Grant will serve as the liaison for the Committee.

1. Approval of Minutes

- Regular Meeting: December 14, 2011

Chair Nolan corrected the word "pull" to "pool" in the second to last paragraph of page 3.

VICE CHAIR WEEKS MOVED TO APPROVE THE MINUTES OF THE REGULAR MEETING OF DECEMBER 14, 2011 AS AMENDED. COMMITTEE MEMBER TRAVOUS SECONDED. THE MOTION CARRIED UNANIMOUSLY BY A VOTE OF THREE (3) TO ZERO (0). COMMITTEE MEMBERS DALLETT AND GULICK WERE ABSENT.

2. Ethics Training

Mr. Padilla provided the Committee with their annual ethics training workshop.

3. Agenda Items

- Discussion and Possible Action of the Desert Discovery Center Phase III Feasibility Committee Annual Report

Mr. Ekblaw presented the Annual Report, which summarizes the attendance, major topics discussed, and actions taken by the Committee over the course of the past year.

VICE CHAIR WEEKS MOVED TO ACCEPT THE ANNUAL REPORT AND FORWARD IT TO CITY COUNCIL AS PRESENTED. COMMITTEE MEMBER TRAVOUS SECONDED. THE MOTION CARRIED UNANIMOUSLY BY A VOTE OF THREE (3) TO ZERO (0). COMMITTEE MEMBERS DALLETT AND GULICK WERE ABSENT.

- Discussion of the Phase II Business Model Revisions

Bob Brais reminded the Committee that when the original report was conducted in August of 2010, mid-range attendance was projected at 333,000, and operating costs, including capital reserves, were projected at $7.4 million. Based on the sensitivity analysis the Committee requested in November of 2011, he reanalyzed the low-range scenario, which was originally projected at 250,000 attendance with an operating cost of $6.6 million. Specifically, the Committee wanted to know whether the DDC could operate feasibly on a budget of only $5 million.

Mr. Brais felt the exercise was helpful in understanding the equilibrium point that this type of attraction could function at. The attendance profile and earned revenue potential is based on the physical product offered, and how it is operated and marketed. If the attendance potential is truly lower than projected, the facility size probably could be reduced, but he emphasized that the original market analysis indicates that the average attendance potential projects higher.

Mr. Brais noted that all of the prognostication was done within the context of great uncertainty. The physical facility itself is only in a conceptual design phase. This is a new type of product, both to the community and overall. It will also be a number of years before the facility can open. In the meantime, market conditions could normalize. Regardless, the facility has to be capable of operating in the bad times as well as the good times.

Mr. Brais said it would be tight to run a facility of the scale proposed for the DDC on a $5 million operating budget. This could have the consequence of generating a somewhat lower attendance figure of 215,000. A key way to reduce the budget to $5 million would be to reduce personnel. The mid-range operation, projects that 79 (Full Time Equivalents (FTEs) would be required. The last low range test case cut it back to 71 FTEs. In this new estimate, the FTEs would have to be reduced to 54, because so many of the other expenditure categories are limited in how much lower they can be cut. Ticket prices were kept the same. The restaurant lease income was reduced significantly. The earned revenue in the new model is about $3.5 million, compared to the midrange scenario of about $5.6 million.

Mr. Brais said if the DDC earned $3.5 million in this scenario because of the lower attendance, and the operating budget is kept in the $5 million range, including the capital reserves, the non-operational revenue target would still need to be at about $1.8 million, which is similar to what was projected for the midrange attendance model.

Vice Chair Weeks inquired what percentage of 215,000 attendance was locally generated versus from outside the area. Mr. Brais responded that the local/tourist ratio was split 50/50, just like the 250,000 projection, and the reduction was pro rata.

Mr. Brais stated that if the DDC draws 250,000 attendance, but the operating budget is kept at $5 million, then the earned revenue would probably be up between $500,000 and $600,000. The required non-operational contributed revenue would be reduced from $1.8 million to about $1.2 million. If the actual attendance were closer to the mid-range projection of 333,000 and the operating budget were reduced from that level, then there might be a better balance and the impact would not be as great. These tradeoffs are made analytically. The $5 million operating budget assumes that the DDC can be run, but not at its full capacity. If that is the route is taken, it could affect attendance negatively, and have implications on the overall success of the DDC.

Mr. Brais reviewed a chart showing revenue per capita numbers, and operational revenue as a percent of total revenue between comparable facilities. He noted that FTE per attendee is a reasonable measure of how an operation lines up with attendance. The DDC's personnel number compares fairly well with other facilities, although it is a little low compared to the ideal. However, the difference would likely consist of frontline personnel who are less costly to add. In summary, he said the $5 million budget and the other models line up well with the comparables, and to each other. Budget cuts would reduce marketing dollars, programs, events, and changing exhibits from the operating budget. Reduced marketing dollars would tend to affect the visitor market, while reduced program and exhibit dollars would tend to affect the resident market.

Mr. Brais said the assumption used in the study is that the DDC would experience an attendance surge at the opening, and would gradually move towards a more stable ongoing attendance. The first year would provide the first clue for where operations would end up. In the original study, the assumption for the first year was 400,000 attendance. If that turns out to the case in the first year, it would indicate that the midrange projection is correct. If the first-year attendance is lower, then management should immediately adjust operations to reflect the likely reality.

Mr. Brais compared the splits between the attendance profiles among the various attendees. The 250,000 profile included 20,000 students. The 215,000 profile reduces that number to 18,500. The impact might be greater in other components of the operations. The restaurant lease was reduced from $20 per square foot to $17.50. Ticket prices were left the same. In the 215,000-attendance scenario, the number of rentals goes down commensurate with the reduction in staff and the level of market interest. Administrative costs, advertising, printing, copying, and publication costs would move downward. Annually, there is a minimum need for capital reserves, even if it is greatly reduced from the original model. This assumes that future needs are not addressed completely.

Mr. Brais summarized that total revenue equals total expenses, in the 215,000 attendance model, at about $5.3 million, which is the $5 million budget plus the capital reserves. The operational revenues would be $3.5 million.

Vice Chair Weeks thanked Mr. Brais for preparing a more conservative look at the budget and attendance numbers. This will help the Committee understand what it might mean if attendance went down and fundraising was not where it needed to be to support the operation. Mr. Brais responded that the working assumption used in all the models is that the DDC is operated in a smart and first-rate manner so that all good opportunities are taken advantage of in all circumstances. With respect to salaries, the assumption is that they had to be high enough to bring in seasoned experienced people right from the start, because smart decisions will be essential. The budget is proposed as a guideline, but it will inevitably change once a real staff is faced with making decisions based on the reality of the day.

Committee Member Travous said this new model serves as a good foundation for those who prefer a more conservative approach. Mr. Brais said that at each step of the process, the City should revisit the underlying market, financial and economic numbers to determine what their implications are. These numbers have to advance as the other aspects of the project advance. Chair Nolan agreed that the new model provides the Committee with an operating expense threshold that reveals the impacts of lower attendance. It will be very useful in that regard.

- Discussion and Possible Action on Recommendation Regarding the Phase II Concepts Including the Business Model

Vice Chair Weeks stated that the most important thing to take away from Mr. Brais' latest analysis is that the DDC can operate on $5 million, depending on what considerations are made in terms of staffing, etc. Chair Nolan agreed. Vice Chair Weeks said the $1.5 million in contributed revenue seems to fall into line with reasonable expectations.

Chair Nolan suggested that the Committee vote on the business model at the next meeting, once Committee Members Dallett and Gulick have provided their input.
Mr. Ekblaw said the Committee is not required to recommend a specific budget, but should be able to say that they have looked at a wide range of possibilities so that there

is an awareness of how to manage the DDC should the least optimistic projections come to pass. The 501(c)(3) organization will be making the management decisions, but it helps TO know that the Committee is sure that they will have a reasonable range to work within to make the DDC a success. Committee Member Travous agreed with the conclusion that the DDC is a manageable risk.

- Discussion and Possible Action on Other Recommendations to City Council

Committee Member Travous noted that the National Park Service created a charter for the National Parks Foundation, which allows the 501(c)(3) to raise money within the National Park Service. It provides an extra layer of protection and an extra measure of freedom to operate within certain parameters. He inquired whether the same situation would be available to the City of Scottsdale. Mr. Padilla responded that he is unaware of a city creating a separate authority as a safety net. Generally, 501(c)(3)s are established with their own set of bylaws, rules and regulations, and cities generally stay away from that. There must be a federal authority that grants the National Park Service the ability to do it that way.

Mr. Peifer inquired whether the City Charter could be amended to allow something like that to take place. Mr. Padilla said it is possible, but the process for doing so would be very long and have to go through a public election. Committee Member Travous said it is very difficult to get a 501(c)(3) and a government to work together, because they have to stand apart. The National Park Service seems to be able to bridge that gap, however.

Vice Chair Weeks said that if a 501(c)(3) runs the DDC, it will be accountable to its board of trustees via a contract with the City, but it would largely be independent.

- Private Financing Update

No update provided.

4. <u>Staff and Committee Updates (A.R.S. 38-431.02(K))</u>

No further updates provided.

5. <u>Public Comment (A.R.S. 38-431.02 (K))</u>

Dan Gruber agreed with the Committee's conclusion that the DDC looks like a viable proposition provided there is good management. Getting the right senior management is crucial, especially if there are concerns about lower than projected attendance and tight budgets. It is better to pay more to get top quality people running the organization, even presuming the lower level positions have to be compressed. Since budgets and attendance interact at all levels, management should be prepared for high attendance levels without locking the DDC into a cost structure that will be inappropriate if they do not materialize. The Musical Instrument Museum used contractors for its first year, rather than permanent employees, and the 501(c)(3) management might consider this option. If a reserve exists and there is a clear path to sustainable operations in the near future, it would be appropriate to draw the reserve down to get the DDC from its starting point to a sustainable point. If the reserve is designed to serve as a bridge to sustainability, it should try to reach that point as soon as possible, as opposed to using money to fill budgetary holes year after year. The local Audubon Society used that approach successfully. Mr. Ekblaw said Audubon's reserve was large enough to cover two years. The Committee could consider recommending a more aggressive reserve.

6. Identification of Future Agenda Items

Mr. Ekblaw said the next meeting is scheduled for January 27 at the Granite Reef Senior Center. February dates could be used to wrap up any remaining business of the Committee.

7. Adjournment

With no further business to discuss, the Committee meeting adjourned at 9:31 a.m.

Respectfully submitted,
A/V Tronics, Inc. DBA AVTranz.